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Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

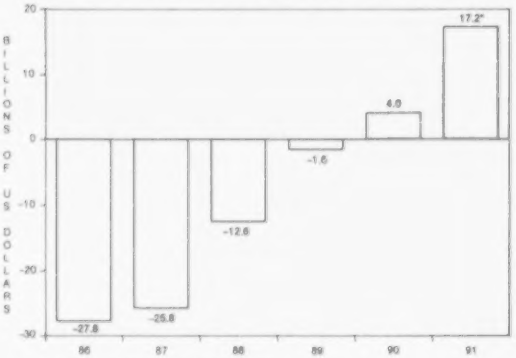
Which Way For The Dollar?

With a seemingly endless string of soft economic statistics dominating the business landscape, inflation rates in check, money supply growth tepid and a Presidential election year just around the corner, expectations abound that the Federal Reserve will continue to loosen monetary policy—driving short-term interest rates even lower while prompting additional near-term downward pressures on the dollar. All of this appears quite reasonable, with the possible exception of the implications for the dollar. For notwithstanding the plethora of well-publicized negatives surrounding the dollar and the lofty level of real interest rates currently underpinning the currencies of the European Exchange Rate Mechanism (ERM), there are some equally good reasons, ranging from a decided improvement in U.S. merchandise trade performance to the likely course of economic developments overseas, to suggest that the dollar's current malaise will not translate into significantly higher trading ranges at least for the European currencies.

The huge turnaround in the U.S. trade balance with Western Europe in recent years lends powerful support to the argument that further dollar depreciation versus the European currencies is unwarranted. Reflecting the combination of robust economic growth throughout Europe in the latter half of the 1980s and the officially-sanctioned policy of dollar depreciation, not only has the once massive U.S. trade deficit with Western Europe been eliminated, but it has been transformed into a large, and growing trade surplus. As shown in the chart, whereas the United States was registering a whopping $27.8 billion trade deficit with Western Europe in 1986—the nadir of U.S. trade woes—during the first eight months of this year the United States was running an annualized trade surplus of more than $17 billion. With the price competitiveness of U.S. manufacturers substantially enhanced, exports to Europe just about doubled between 1985 and 1990, far outpacing the growth of sharply higher priced European imports.

The widening trade surplus with Western Europe could, however, eventually prompt significant exchange rate friction, just as it did in the mid-1980s when the shoe was on the other foot. While further depreciation of the dollar may be welcomed by U.S. exporters and economy-concerned policymakers alike, such a development will increasingly run into a wall of resistance in Europe. For one thing, European policymakers,

U.S. MERCHANDISE TRADE BALANCE WITH WESTERN EUROPE



Source: Commerce Department
*Jan.-Aug. 1991 at annual rate

many of whom already consider the dollar undervalued, cannot help but be concerned about the health of their own domestic industries in the face of increasingly stiff U.S. competition. For another, suspicions have been heightened that the United States, frustrated at its inability to correct a yawning $40 billion trade deficit with Japan, is attempting to compensate for this policy failure at the expense of the European Community. Since misaligned exchange rates often lie at the heart of hefty trade imbalances, it may not be too long before more vocal calls are heard from across the Atlantic for a higher, rather than a lower-valued dollar.

Beware Of U.S. Interest Rate Myopia

To be sure, the perceived "cheapness" of the dollar, and recent U.S.-European trade developments, lend the U.S. currency a fair degree of longer-run support. This does not necessarily mean, however, that a near-term tumble is out of the question, especially when you consider that shorter-term exchange rate movements tend to pivot around international interest rate differentials. And, at first glance, the dollar appears to be at a distinct disadvantage. As long as the U.S. recovery continues to sputter, the likelihood of even lower interest rates is never far removed. But, it would be premature, not to mention myopic, to assume that the dollar will move in lockstep with each downturn in domes-

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tic interest rates. This is because interest rates almost everywhere else are, or will soon be, moving lower as well.

Throughout large chunks of Europe, including France, Italy and the United Kingdom, as well as Japan, business activity either remains lethargic or is slowing to a crawl. Even the once robust German economy appears poised for a decided deceleration, due to a persistently tight monetary policy, higher taxes imposed to rebuild the five eastern provinces and a waning of the post-unification spending boom in those provinces which powered economic growth in the western section. In Germany, consumer and business confidence is declining, retail sales flattening, automobile sales softening and capital spending plans vanishing. In this environment, it is only a matter of time before European monetary policies turn more stimulative and a pan-European lowering of interest rates unfolds.

So, too, a weakening economy and a brightening inflation picture have prompted the Bank of Japan to ease monetary policy. The central bank's discount rate has been cut twice since July and bank reserve requirements have been trimmed, driving short-term interest rates lower. As a result, no longer does the United States find itself the "odd man out" in the ac-

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/30/91)	172,745	- 1,884	- 35,760
New York City (11/6/91)	29,078	+ 664	- 6,335
Commercial Paper (11/6/91)	532,293	+ 5,737	- 26,412

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/30/91)	295,576	- 1,057	- 23,882
New York City (11/6/91)	52,775	+ 182	- 5,037

Total Loans and Leases Gross Adjuste

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/30/91)	1,007,291	+ 394	- 13,259
New York City (11/6/91)	165,587	+ 1,262	- 12,993

Financial Markets

	Friday 11/15/91	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	4.71%	- .03	- 2.59
180-Day Bills†	4.79	- .07	- 2.57
Longest Bills†	4.88	- .06	- 2.38
Recent Issues:			
6s 10/31/93	5.53	- .08	
6⅞s 10/31/96	6.57	- .08	
7⅛s 11/1/01	7.34	- .07	
8s 11/15/21	7.84	- .03	
Municipals:			
Bond Buyer—20 Bond Index* (11/14/91)	6.69%	- .02	- .46
Blue List Total ($ Million)	$1,215	- $ 10	+$ 116
30-Day Visible Supply ($ Million)	$3,717	- $777	+$2,678
Total	$4,932	- $787	+$2,794
Corporates:			
Moody's Aa Composite (11/14/91)	8.72%	- .08	- .89
30-Day Visible Supply ($ Million)	$ 275	- $125	- $ 575
Stocks:			
Dow-Jones Averages:			
Industrials	2,943.20	- 102.42	+392.95
Transportation	1,225.53	- 40.17	+361.25
Utilities	215.95	- 2.88	+ 7.70
65 Stocks	1,069.96	- 33.20	+179.22
N.Y.S.E. Composite Index	211.92	- 4.90	+ 38.62
N.Y.S.E. Avg. Daily Vol. for Week (000's)	190,519	+ 13,809	+26,700

*34% Taxable equivalent 10.14%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 11/15/91	Week Ago
Overnight	4.88%	4.75%
1 month	4.81	4.81
3 month	5.00	4.94
6 month	5.00	4.94
1 year	5.13	5.06

FOREIGN EXCHANGE SPOT RATES

New York Opening (11/15/91)	Currency Per U.S. $	Week Ago
Belgium	33.63	33.91
Canada	1.1310	1.1245
France	5.5820	5.6260
Germany	1.6328	1.6470
Italy	1231.00	1238.00
Japan	129.95	130.20
Mexico	3075.00	3075.00
Netherlands	1.8400	1.8554
South Korea	736.19	738.16
Switzerland	1.4472	1.4548
Taiwan	25.60	25.85
U.K.*	1.7717	1.7640

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (11/15/91) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	-0.1%	-11.8%

tual, or anticipated thrust of monetary policy and the direction of interest rates, diminishing the relative luster of both the Deutschemark and yen. In fact, investors may find themselves turning increasingly ambivalent toward the U.S., German and Japanese currencies, potentially locking them into narrow trading ranges for quite some time.

Setting The Stage For A Rebound

Nonetheless, whereas the anticipated convergence of growth rates and monetary policies among the major industrial countries is now serving to dampen volatility, the opposite may be the case next year. With interest rates standing lower for longer in the United States than elsewhere, today's admittedly modest economic upswing could gather momentum in 1992, outdistancing growth rates abroad. If so, monetary policies and interest rates would begin to diverge as well, setting the stage for enhanced market volatility. Since quicker U.S. growth will be accompanied by a firming of interest rates here, the compression of international interest rate differentials could produce an across-the-board dollar upswing in 1992. And, if the United States manages to hang on to a healthy portion of its recent trade balance gains, the dollar's rebound might be not only well-rooted, but sizable as well. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 11/13/91	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	269.466	+ 1.910	+23.598
Loans to Depository Inst.	.105	- .017	- .183
Float	.517	- .283	+ .004
Total Reserve Bank Credit	302.372	+ 1.952	+14.943
Treasury Deposits with Federal Reserve Banks	5.832	- 2.077	+ .362
Currency in Circulation	299.051	+ 2.123	+21.370
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	250.521	- .693	+ 9.079
Member Bank Reserves:	**11/13/91**		
Total Reserves Held	52.832	+ 1.454	- 7.270
Excess (Deficiency)	.917	- .273	- .065
Net Free Reserves	.805	- .174	+ .080

Monetary Aggregates †		‡ % Change Since 3 Months Ago*	% Change Since Year Ago
M1 (11/4/91)	884.0	+ 8.6	+ 7.4
M2 (11/4/91)	3,402.5	+ 1.6	+ 2.5
M3 (11/4/91)	4,141.8	- 0.3	+ 1.2
Domestic Nonfinancial Debt (2nd Q'91)	10,735.3	+ 4.6	+ 5.0

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 11/15/91	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	4.74%	4.83%	4.91%
* Federal Agencies	4.83	4.88	5.00
* Municipal Notes–High Grade (34% Taxable Equivalent)	6.06	6.06	6.44
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	5.02	5.00	5.05

‡ Finance Company Paper–Prime

5- 14 days	4.88%
15- 29 days	4.88
30- 59 days	4.92
60- 89 days	5.00
90-179 days	5.00
180-239 days	5.00
240-270 days	5.00

‡* Bankers' Acceptances

Dec.	4.80%
Jan.	5.00
Feb.	4.86
Mar.	4.84
Apr.	4.80
May	4.78

‡ Industrial Paper–Prime

30- 89 days	4.93%
90-120 days	4.90

†Federal Funds Effective Rate 4.88%

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'91	$ 5,671	$ 5,612	$ 5,515
Gross National Product (1982 Dollars)*	3rd Q'91	$ 4,143	$ 4,119	$ 4,170
Percent Change, Annual Rate	3rd Q'91	+ 2.4	- 0.5	+ 1.4
Change in Consumer Prices*	Oct '91 n	1.2%	4.8%	7.2%
Change in MH Cost of Living Index*	Oct '91 n	1.2%	3.6%	3.6%
Change in Producer Prices*	Oct '91 n	8.4%	1.2%	14.4%
Civilian Employment (Thousands of Persons) †	Oct '91	116,967	117,165	117,733
Unemployment as % of Civilian Labor Force †	Oct '91	6.8%	6.7%	5.7%
Personal Income*	Sep '91	$ 4,847	$ 4,824	$ 4,698
Leading Indicators Composite Index (1967=100) †	Sep '91	145.4	145.5	143.2
Industrial Production Index (1977=100) †	Oct '91 n	108.2	108.2r	109.9
Net Change in Consumer Installment Credit †	Sep '91 n	- $ 1.54	- $ 0.85r	+$ 1.70
U.S. Merchandise Trade Balance †	Aug '91	- $ 6.76	- $ 5.95	- $ 9.35
Plant and Equipment Expenditures'	4th Q'91	$ 540.9(a)	$ 539.5(a)	$ 529.0
Private Housing Starts (Thousands of Units)*	Sep '91	1,033	1,056	1,106
New Construction Expenditures*	Sep '91	$ 406.5	$ 402.1	$ 437.2
Total Business Inventories †	Sep '91 n	$ 811.7	$ 806.6r	$ 826.0r
Total Business Sales †	Sep '91 n	$ 542.0	$ 539.6r	$ 549.8r

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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Bank Window, Church St. Station
New York, N.Y. 10015

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